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Antitrust, Company Law and Corporate „Mega-Mergers“
A Comparison of American and European Union Approaches

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Antitrust, Company Law and Corporate "Mega-Mergers"
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In the last few months, we have witnessed a new wave of corporate mergers on both sides of the Atlantic. In fact, the largest corporate merger ever in Europe and the largest ever in the United States have recently been announced. These mergers, Bell Telephone/TCI[1] in the United States, Akzo/Nobel in Europe,[2] have joined others that have also received much attention such as the hotly contested takeover battle for Paramount Pictures,[3] MCI-British Telephone joint venture,[4] and the recently abandoned Volvo/Renault automobile marriage.[5] While a number of the more widely-publicized of these "megamergers" have collapsed for business reasons, it is noteworthy that legal considerations have played only a minor role in the debate over their propriety.

In analyzing the phenomenon of large corporate mergers and their legal consequences, I want to first examine what prompts these huge companies to get in bed with each other - specifically, what makes these combinations potentially beneficial to society and what possible harms could flow from these mergers. Second, to borrow from a famous American, Tina Turner, I want to ask, "What's Law Got to Do With It"? That is, what role the legal systems of the United States and the European Union play with regard to these "megamergers." Third, I will offer a few observations about Merger Control in the European Union and the prospects for harmonizing substantive laws governing mergers around the world.

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1 Sandra Sugawara, Bell Atlantic, TCI Call Off Merger, Washington Post (February 24, 1994).

2 See EC Clears Merger of Complementary AKZO/NOBEL Intermediates Business, 66 Antitrust and Trade Reg. Rep. 128, Jan. 27, 1994.

3 See VIACOM Proposes 9 Changes in Proposed FTC Order Against TCI/Liberty, FTC: WATCH, Feb. 14, 1994; Paramount Communications, Inc. v. QVC Network, 637 A.2d 34 (Del. 1994).

4 U.S. v. MCI Communications Corp. and BT Forty-Eight Co., 59 Fed. Reg. 33009 (1994) (consent decree).

5 Patrick Frater, U-Turn Forces Volvo Merger Off the Road, London Times (December 12, 1993).

I. The Economic Costs and Benefits of Mergers

Mergers are not a recent phenomenon - the enormous flood of takeovers in the 1980s in the US and in Europe was only one of a number of "merger waves" that seem to periodically occur. Indeed, they seem to occur both in good economic times and bad. It was the great rush of combinations after the Industrial Revolution in the United States gave birth to the American antitrust laws passed in 1890 and supplemented in 1914.[6] American Presidents, including Theodore Roosevelt and Woodrow Wilson, have made these issues prominent in their election campaigns and legislative agendas.

What, then, are the reasons these large companies feel the need to merge with each other? Most laymen and businessmen would probably guess that "efficiency" is the primary motive.

Realizing cost savings, economies of scale, or synergies between the two parties that make the whole larger than the sum of its parts, at first blush, would seem to drive most mergers. Remember, however, what America witnessed in the 1980s and 1990s: mergers of enormous industrial giants whose plants had already achieved minimum efficient scale, that could by themselves take advantage of most opportunities for cost savings, and possessed (or could purchase) whatever expertise or licenses they needed to succeed in the market. In many cases, the source of the impetus to merge seems more subtle and inchoate - such as facilitating entry into new markets or crossing national borders that may be hard to penetrate by means other than merger because of cultural barriers or other obstacles. In today's troubled economies, a third reason is sometimes suggested by the business community - reducing excess capacity by helping downsize industries with too many competitors. Here, too, it is not apparent that this factor explains well the merger phenomenon: it is far from clear, for example, why mergers make difficult cost-cutting steps any easier to accomplish, although in certain circumstances they may help overcome strategic problems that keep industries from reducing capacity.

Therefore, although it is often assumed that mergers are undertaken for sound business

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6 Robert Lande, Wealth Transfers as the Original and Primary Concern of Antitrust: The Efficiency Interpretation Challenged, 34 Hastings L.J. 65 (1982).

reasons and offer the promise of improving the economic health of the firms, the purported benefits are often illusory on closer examination. Indeed, an empirical study of American mergers in the 1970s by two economists, Scherer and Ravenscraft, revealed that a large number of corporate mergers (particularly conglomerate mergers) did not work out well.[7] Overall, mergers did not result in greater profits - indeed, many large companies wound up selling off the very assets they had only recently expended great energy and vast sums of money to purchase.

On the other side of the coin, what risks do mergers pose? Just as the benefits from mergers are often uncertain and not readily predicted, the potential harms are often difficult to identify. First, there is the risk that competition will be lessened - this is antitrust law's primary concern. When a company merges with a competing company it reduces the number of competitors and it may establish either a dominant (monopoly) position or be one of a few remaining companies (oligopolists). Economics teaches us that these situations harm consumer welfare by increasing price and reducing output or quality. As I will discuss in a minute, the Commission of the European Union has treated oligopoly rather gingerly, recognizing the problem in its merger jurisprudence only recently and even then taking a very cautious approach to attacking such mergers. This caution is somewhat surprising to an outsider, given the economic tools available today for identifying problematic oligopolies and the considerable experience of member states (particularly the Federal Republic of Germany) in addressing the issue.

Monopoly and oligopoly are, of course, real risks, but remember that most megamergers involve companies that in large part are not competitors - they usually manufacture different, perhaps complementary, products or serve different geographical markets.

Economists do not view these so-called "conglomerate mergers" as posing much of a threat to consumer welfare. Most probably agree in fact that they are, from an economic standpoint, not harmful at all.[8] On the other hand, many politicians are still highly suspicious of such

7 David J. Ravenscraft & F.M. Scherer, Mergers, Sell-Offs, and Economic Efficiency (1987).

8 See Robert Bork, The Antitrust Paradox: A Policy in Search of Itself (1979).

mergers because they tend to concentrate too much economic and political power in the hands of a few.

The second kind of risk posed by large corporate mergers lies in the nature of the modern corporation itself and helps explain why some large (and seemingly pointless) mergers are undertaken in the first place. That is, the managers of large corporations - CEOs, presidents, officers - have long been suspected of maximizing not their shareholders' interests, but their own. "Empire building", growth for growth's sake, and increasing the perquisites of corporate offices have been identified as powerful forces affecting corporate decision makers.[9] To give one well-known example in the United States, the takeover contest involving RJR-Nabisco illustrated many of these tendencies. One fascinating account is the best-selling book, Barbarians at the Gate which describes the extravagant ways of the corporate executives running RJR.[10] It points out that officers of RJR had their own air force - a fleet of executive planes filling an entire hangar that were not rationally related to business needs, as well as penthouses and other perquisites of office. That takeover contest was notable for the fact that the RJR executives spent most of their efforts protecting their own interests in choosing a merger partner - not looking after the welfare of the stockholders, the long-term future of the company, or the workers.

Coping with the problem of managerialism or other impulses that overshadow the interests of the corporation is the responsibility of company law (or corporate law, as it is referred to in the United States). This body of law seeks to ensure that corporate executives and directors remain faithful to their duties to the corporation and do not substitute selfish goals for those that maximize shareholder welfare.

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9 See Robert C. Clark, Corporate Law, 26 (1986).

10 Bryan Burrough & John Helyar, Barbarians at the Gate (1990).

I will next briefly examine both antitrust and company law to see how they deal with the two threats posed by large mergers that I have been discussing and also to consider how well the legal system does in distinguishing harmful mergers from the beneficial.

II. Antitrust Law

First, let me address the competitive (antitrust) aspect of mergers. As mentioned above, antitrust risks arise primarily when competing entities merge and there are few remaining rivals or the merged company becomes the dominant firm in the market as a result of having acquired its competitors. The nature and magnitude of the potential harm has been a source of some dispute among legal and economic scholars. There is a wide consensus of course that monopolies harm consumer welfare, but the oligopoly problem - the market with only a few firms - has been controversial. Actually, most oligopoly theory and a good deal of empirical research shows that markets with a few firms have higher prices than those with a large number of competitors, other things equal.[11] The controversy in legal circles has been over whether law should try to identify those situations in which concentrated market structures do not follow this pattern - i.e. they remain competitive despite high market shares - or whether the law should adopt general presumptions of illegality for concentrative mergers despite the fact that some are probably not harmful.

The practical side of this debate is reflected in the different treatment of mergers by the legal regimes of Europe and North America. Some legal systems - especially the Federal Republic of Germany and the United States - have adopted such presumptions while others, like France, have not. Most interesting is that the text of the European Community's Merger Regulation, which governs only extremely large mergers (i.e. those involving companies with over 5 billion ECUs in annual turnover and meeting other requirements) has not even addressed the oligopoly problem. Until the recent Nestlé/Perrier case, which I will discuss in a moment, the Commission attacked only dominant firm (monopoly) mergers. And it did so only occasionally. Only one merger has been blocked and a handful conditionally approved in the three years that the Merger Regulation has been in effect.

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11 See Blair and Kasserman, Antitrust Economics (1986).

Many analysts feel that merger regulation needs to be harmonized - not only within the European Union, but globally, so that companies cannot pick and choose where to incorporate or with whom to merge according to which member State has the most user-friendly antitrust laws. However, if the national antitrust authorities can pick and choose among economic theories and enforce their merger law only sporadically, a legitimate question exists as to whether there can ever be harmonization, even if a single standard of law is adopted. Thus, the zeal with which national agencies enforce antitrust statutes may be as important as the text of the statutes themselves.

A. Horizontal Mergers

Let me turn to some of the mechanics of antitrust analysis to illustrate this point. It is interesting to note how very fact-specific competition law is and also that very similar rules of analysis seem to be evolving in the European Union and United States. Antitrust analysis of horizontal mergers (i.e., those involving firms that compete with each other in at least one market), in most nations proceeds in five steps[12]: first, the factfinder identifies the product markets in which the two firms compete; second, he fixes the geographic markets; third, he measures the market shares of the two firms and concentration of the market; if the market shares are so high as to create a presumption of illegality, the fourth step is to evaluate other factors that might suggest that competition may not be harmed. These factors include ease of entry into the market, the existence of powerful buyers and whether collusion is likely given the structural characteristics of the market. Finally, if the preceding analysis suggests an anticompetitive merger, the factfinder then asks whether there are cognizable defenses such as whether the company is failing or if there are significant offsetting efficiencies that should lead to approval despite the risks to competition.

12 Compare, United States Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines (1992) with Control of Concentration Between Undertakings, "Merger Regulations" Council Regulation No. 4064/89, O.J.L. 395/1 (1989). See generally, Damien Neven, et al., Merger in Daylight: The Economics and Politics of European Merger Control (1993).

Note, incidentally, what antitrust does not ask. It does not ask whether the merger promotes industrial policy, whether it hinders or advances social objectives or increases or decreases jobs. This is the case in the United States and most (but not all) European member states. Recently however, Karel Van Miert, the Minister for Competition of the EU, announced that jobs might be a "tie-breaker" in close cases for the EU. What this means is far from clear. However it does represent a very controversial and, in my judgment, questionable mingling of political objectives and legal analyses that would be hard to enforce. Let me pose a few of the problems raised by what probably seems to most people to be a perfectly sensible proposal.

At the outset, one must question how an agency will be able to measure in a principled way how many jobs (and specifically how many European jobs) will be created or saved. Recall also that the effect of the merger under evaluation will be to lessen output and thus will presumably reduce the net total of jobs industry-wide, so that the agency will have to be able to calculate that loss and offset it against any job-creating propensities. Next, consider the effect of an efficiency-enhancing merger that lowers costs by consolidating the operations of the two firms and reducing jobs. Is the Commission prepared to block mergers that improve a European company's competitiveness on the basis of its effect on jobs? Finally, what if the response of other nations was to start to factor in their favored social objectives (e.g., environmental protection, reducing the decline of urban areas, promoting opportunity for the disadvantaged)? The risk of converting antitrust into a catch-all policy instrument is considerable and has the potential to create yet another obstacle to free trade.

Let me return to how antitrust law works in practice. On the product market issue, the central questions are usually: Do the products of the two companies compete?; and if so, do those products compete with others that must be considered as part of the same "relevant market"? In a merger like Akzo/Nobel there might be dozens of chemicals, paints or other products that the two firms produce and each may constitute a separate product market. But the precise boundaries of the product market are not always obvious. Two cases, one in U.S. other in EC illustrate the complexity of delineating what products are appropriately considered "in" the product market and what products are not.

A few years ago the Federal Trade Commission in the United States challenged a merger between Coca Cola and another soft drink, Dr. Pepper.[13] The question was: do soft drinks compete with other beverages, and if so, which ones? Coca Cola's creative lawyers and economists contended that soda competes with water, beer, milk, juice, whiskey - in short, anything that can be poured into the human stomach. The stomach's capacity was limited, so every drink was a substitute for soft drinks.

A similar issue was considered by the Commission of the European Community a little over a year ago in the Nestlé/Perrier case.[14] The question was: do bottled source waters compete with other beverages such as tap water, non-source bottled water, and sodas. If the answer was affirmative, the merger between two source water producers (which established a duopoly controlling over 80% of the French market) would not make any difference because consumers had adequate substitutes. The somewhat more restrained lawyers for Nestlé argued that, from the consumers' point of view, the substitutes for source water were all other drinks that quenched thirst.

It is encouraging to note that the Commission for the European Community and the American Federal Court applied essentially the same analytic framework and reached similar conclusions. Soda was found to constitute the relevant market in the American case and bottled source waters the relevant market in the EC case. In both, the issue was correctly framed as one of substitutability by consumers, i.e., do customers switch freely between these products? Given significant differences in price, consumers tended not to regard other drinks as alternatives. Both tribunals looked closely at pricing patterns of alleged substitutes, marketing practices, and other practical indicia of economic reality to reach these conclusions.

Similar principles are used to establish the geographical dimension of the market. In Nestlé/Perrier, the Commission examined transportation costs, shipment patterns and the preferences of the French consumers and found the market to be national. (For reasons I cannot appreciate - probably owing to my own cultural handicap of not having a sufficiently

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13 FTC v. Coca Cola, 641 F.Supp. 1128 (D. D.C. 1986).

14 Nestlé/Perrier, Commission Decision of 22 July 1992, 1992 O.J. (L 356) 1.

sensitive palate - the French will only drink French source waters). The test again is not necessarily physical similarity, but customer preferences at the competitive price.

Defining geographic markets is an especially difficult task in Europe because doing so is a bit like trying to shoot at a moving target. With national barriers falling, procurement directives mandating greater cross-border purchases, and harmonization of technical standards, today's market in Europe is surely not tomorrow's. Nevertheless, the Commission has, realistically in my view, often identified national markets in its cases, recognizing that national barriers do not disappear quickly despite the decrees or wishes of their governments.

Other issues also pose difficult judgments. One recently decided by the Commission concerned how much leeway should be afforded to a failing company. The merger involved an East German potash company acquired by the dominant German potash company. The former East German company was, by all accounts, unable to compete - and surely would have gone out of business if it had not been acquired by someone.[15] The difficult question for antitrust law was under what circumstances should what is by far the largest rival in Germany be allowed to acquire such a firm. The answer was to allow the merger given evidence that failure was both certain and imminent, that no less anticompetitive partner could be found, and the business of the acquired firm was likely to be obtained by the acquiring firm even without the merger.

Mergers also present a host of other issues requiring careful evaluation. Unfortunately, antitrust agencies on both sides of the Atlantic have not been entirely successful in dealing with several of these complexities. The result has been a tendency to approve mergers of firms with very high market shares based on rather dubious economic rationales. In some cases in recent years, for example, both American Courts and the Commission have been beguiled by the supposed ease of entry into markets as an offsetting factor against other strong evidence of anticompetitive harm.[16] These cases have ignored the critical point that it is not enough that some firm is likely eventually to enter the market; it is necessary to evaluate how

15 Kali und Salz AG/Mitteldeutsche Kali AG, Case No. IV/M.308 (14 December 1993).

16 See Barry E. Hawk, United States, Common Market and International Antitrust: A Comparative Guide.

effective that entrant will be in deterring supracompetitive pricing. Moreover, it is crucial to evaluate the entry lag - i.e., how long it will take for entry to occur. As the United States Justice Department's Merger Guidelines recognize, there is no reason to tolerate misallocation of economic resources resulting from a merger simply because eventually competition will erode the monopolist's or oligopolists' power.[17]

Another misused economic tenet has been the potential of powerful buyers to reduce risks of anticompetitive practices or monopoly pricing raised by mergers. As analyzed by some American courts and the Commission of the European Union, the prophylactic effect of "power buyers" is taken as an article of faith.[18] Yet economic analysis teaches that even powerful buyers must have good information, reliable alternatives and sufficient incentives (in terms of competition for their own products and a significant amount of the input must be used in their production process) to act as effective policemen. Perhaps the best counter-example to the assumed vigilance of power buyers is the record of United States Department of Defense. Despite its obviously formidable role as a buyer of military equipment and supplies, the Pentagon has been a frequent victim of price-fixing schemes over the years. The U.S. Department of Justice has brought countless criminal price-fixing cases against collusive bidding schemes in this area.

B. Vertical Mergers

Several large vertical mergers (e.g., those involving firms standing in a customer-supplier relationship) have been challenged recently on the basis of their vertical concerns. In general, these mergers can pose the risk that competitors will be cut off from needed sources of supplies, technology or sales opportunities, or they may raise barriers to entry.

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17 U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines, § 3.0 (1992).

18 See, e.g., U.S. v. Baker Hughes, 908 F.2d 981 (D.C. Cir. 1990); U.S. v. Syufy Enterprises, 903 F.2d 659 (9th Cir. 1990).

Antitrust has been particularly concerned with mergers in the telecommunications industry that enable firms to extend existing market power into other markets or create new market power. These mergers are "vertical" in the sense that they involve companies at different levels of distribution, as is the case for example, with a merger between a cellular phone company and a company providing long distance telephone services. In agreeing to a consent decree involving the $12.6 billion merger between McCaw Cellular, America's largest cellular telephone service company, and AT&T, the largest interexchange (long distance) carrier and cellular equipment manufacturer, the U.S. Department of Justice explained its concerns about such effects.[19] It allowed the merger to go forward on two conditions: First, that the merged entity take steps to reduce the risk that AT&T would eliminate competition in long distance services it provides to customers of its cellular services. Second, AT&T-McCaw was required to assist cellular services companies in switching cellular equipment vendors where competitive problems exist.

Vertical concerns also were at the source of the United States Department of Justice's antitrust allegations in its challenge to the stock acquisition and joint venture involving British Telecommunications and MCI Communications, Inc. That case, also resolved by consent decree, was predicated on the potential that BT might use its dominant position in the United Kingdom to disadvantage competitors of MCI in the United States through discriminatory practice with respect to international correspondent services needed by all international services providers.[20]

III. Company Law

I will now turn briefly to company law. As I mentioned at the outset, company law seeks to assure that officers and directors remain faithful trustees to the interests of their corporations. It does this by imposing fiduciary duties on these individuals to act with care (the "duty of care") and to avoid self-interested transactions or conflicts of interest (the "duty of loyalty").

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19 U.S. v. AT&T Corp. and McCaw Cellular Communications, Inc., 59 Fed. Reg. 44158 (1994) (consent decree).

20 U.S. v. MCI Communications Corp. and BT Forty-Eight Co., 59 Fed. Reg. 33009 (1994) (consent decree).

The legal system has to step in because it is clear that in many large corporations those running the business are simply not accountable to anyone. A sizeable economic literature on the so-called "agency costs" of the modern corporate enterprise explains why this is so.[21]

The traditional model of corporate democracy posits that shareholders elect directors who, in turn, hire, monitor and, if necessary, fire officers and managers. The reality in most large publicly-traded American corporations is that no such monitoring takes place. It is the officers who choose their friends or allies as board members; moreover, the board has neither adequate staff or information, even if they were so inclined, to do anything that could be called active supervision. Shareholders are too numerous and uncoordinated to exercise their powers effectively. As a result of agency costs, then, corporate managers have often the freedom to do pretty much as they please, resulting in the kinds of excesses that the RJR-Nabisco merger discussed earlier illustrated. These problems, however, are less difficult in nations such as Germany in which banks hold large blocks of shares and are able to more carefully monitor their directors' actions and to play an important supervisory role through advisory committees; further, unions have a more direct voice in company management which also serves as a check on managerialism.

To some economists, however, there is no need for law to play much of a role at all. Under this view, the "market for corporate control" will police managers who might go astray.[22] (The question for these authorities to answer, of course, is how there could have been such extraordinarily high premiums in takeover bids for companies if the capital markets could be counted on to discipline managers.) Nevertheless, this viewpoint has been highly influential in contributing to the watering down of the importance of fiduciary duties in American corporate law jurisprudence.

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21 See Adolph A. Berle & Gardner C. Means, The Modern Corporation and Private Property (rev. ed. 1948); see also Jensen & Meckling. Theory of the firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. Fin. Econ. 305 (1976).

22 Jensen & Ruback, The Market for Corporate Control: The Scientific Evidence, 11 J. Fin. Econ. 5 (1983).

The role that the fiduciary duties play in policing corporate mergers is as follows. Directors who fail in extreme cases to look after the interests of the corporation, and specifically its shareholders, will be held to have breached the fiduciary duty of care; where the lack of effective performance is attributable to the directors' conflicts of interest, the duty of loyalty is implicated. In either case, negligent or disloyal directors may be personally liable for damages suffered by the corporation as a result of the merger. In one noteworthy American case, Smith v. Van Gorkum[23], the directors of a company who paid no attention to the details of the bidding for their company in a takeover battle, were held personally liable for millions of dollars representing the lost premiums in the prices the shareholders received for their stock.

More recently, the bidding for Paramount pictures by two companies, QVC and Viacom, raised these issues. Viacom began the bidding with a friendly takeover bid for $8.2 billion. ("Friendly" here means that the management and Board of Paramount did not expect to lose their jobs and were receptive to the offer.) QVC jumped in with a "hostile" bid, initially offering $9.8 billion. Even at these hard-to-comprehend figures, the difference of $1.6 billion seems rather significant; at least the stockholders of Paramount felt it was. However, the Board, looking after its own interests, had entered into deals favoring the lower bidder, Viacom and adopted "poison pills" and other devices to prevent any takeover of which they did not approve. The courts were asked to determine whether the Board of Directors could so stack the deck against the stockholders' obvious interests. The Delaware Supreme Court has just recently concluded that in taking these defensive actions, the directors violated their fiduciary duties and hence the defensive measures were null and void.[24]

On the other side of the coin, however, is the question of whether a corporate board of directors should be able to block takeovers that might be in the short term interest of corporate shareholders, but perhaps not in the long-term interest of the corporation or the community in which it operates. The solutions devised so far by the legal systems in the United States and Europe are not altogether satisfactory however. In the United States, many

23 488 A.2d 858 (Del. 1985).

24 Paramount Communications, Inc. v. QVC Network, 637 A.2d 34 (Del. 1994).

state governments have passed laws empowering boards to "take into account" the effects of mergers on the local community, the workers, and "other constituencies" besides shareholders. While this sounds perfectly reasonable, there is a substantial question as to whether this shield against shareholder claims of breach of fiduciary duties might actually empower boards to look after their own selfish interests under the mantle of protecting their workers, communities, or others. In Europe, the solution has in some cases been government ownership or retention of a "golden share" to protect the social interests of the state. As recently illustrated in the Renault/Volvo merger, however, this is not necessarily an attractive solution from the perspective of the marketplace or of persons who are citizens of other countries. As in that case, too much political power over the company may make it less attractive in capital markets and less able to secure partners outside of its own national borders.

IV. Conclusion

The question I posed at the beginning was: what does law have to say about corporate "megamergers"? The answer has been that antitrust will look closely at mergers between competitors and occasionally at vertical combinations, but not concern itself much about any others. Moreover, national authorities may manipulate even those inquiries because the issues are so fact-specific and subject to administrative justification. Corporate law does look at the broader issue of accountability of the corporate enterprise, but that task is fraught with difficulties. It is indeed a difficult assignment to strike a balance between controlling directors' selfish impulses while not giving in to the short-term focus of the marketplace.